

Via Email

November 2, 2021

The Honorable Brad Sherman
Chair
Investor Protection, Entrepreneurship and Capital Markets Subcommittee
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
Investor Protection, Entrepreneurship and Capital Markets Subcommittee
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: H.R.____, To amend the Securities Exchange Act of 1934 to improve the governance of multi-class stock companies, to require issuers to make annual diversity disclosures, and for other purposes,¹ and H.R.____, The Accelerating Holding Foreign Companies Accountable Act²

Dear Mr. Chairman and Ranking Member Huizenga:

The purpose of this letter is to: (1) reiterate the Council of Institutional Investors' (CII) support for the discussion draft of a bill to amend the Securities Exchange Act of 1934 to improve the governance of multi-class stock companies, to require issuers to make annual diversity disclosures, and for other purposes (Stock Exchange Improvement Act);³ and (2) to express CII's support for the discussion draft of the Accelerating Holding Foreign Companies Accountable Act (Accelerating Act). We respectfully request that this letter be included in the public record of

¹ To amend the Securities Exchange Act of 1934 to improve the governance of multi-class stock companies, to require issuers to make annual diversity disclosures, and for other purposes, H.R.____, 117th Cong. (discussion draft Sept. 24, 2021), <https://financialservices.house.gov/uploadedfiles/bills-117pih-improvinggovernanceatmulti-classstockcompanies.pdf>.

² The Accelerating Holding Foreign Companies Accountable Act, H.R.____, 117th Cong. (discussion draft Oct. 20, 2021), https://financialservices.house.gov/uploadedfiles/bills-117pih-hr____acceleratingholdingforeigncompaniesaccountableact.pdf.

³ See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. 1 (Oct. 1, 2021) (“The purpose of this letter is to express our strong support for ‘H.R.____, To amend the Securities Exchange Act of 1934 to improve the governance of multi-class stock companies, to require issuers to make annual diversity disclosures, and for other purposes’”), [https://www.cii.org/files/issues_and_advocacy/correspondence/2021/October%201,%202021%20letter%20to%20C%20ommittee%20on%20Financial%20Services%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2021/October%201,%202021%20letter%20to%20C%20ommittee%20on%20Financial%20Services%20(final).pdf).

your October 26, 2021, hearing, “Taking Stock of China, Inc.: Examining Risks to Investors and the U.S. Posed by Foreign Issuers in U.S. Markets”(Subcommittee Hearing).⁴

CII is a nonprofit, nonpartisan association of United States (U.S.) public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$40 trillion in assets under management.⁵

Stock Exchange Improvement Act

At the Subcommittee Hearing, Committee on Financial Services Chairwoman Maxine Waters provided the following insightful comments and questions relating to “dual class[-]share structures”:

. . . [I]t is reported that many China-based companies desire to be listed on the U.S. stock exchanges. Not only because our markets are large and liquid, but because our stock exchanges permit Initial Public Offerings or IPOs with something called dual[-]class share structures.

Dual[-]class structures allow elite shareholders, most often company founders and executives, to have [a] disproportionately large portion of the company voting power. This structure has been used by many companies from mainland China. In fact, at least five of the top 10 U.S.[-]listed[,] China-based companies have dual[-]class structures.

What I find interesting is that China's own exchanges or the London Stock Exchange, for example, banned the practice of dual[-]class structures for IPOs. Ms. Sutter, how does the dual-class share structure permitted by our stock exchanges create risk to our investors? Why do China-based companies make use of this structure? Should our exchanges limit China-based companies['] ability to offer dual[-]class share structures?

And I find this situation very interesting and I question whether or not we can question China when we use the same structures. And if we're questioning them, because as I'm told China has more control over these big business[es] -- these owners, these top business people and they direct them and they can tell them what to do and somehow that's a difference between what they do and what we do. Can you help me out with this discussion?

. . . .

⁴ Taking Stock of China, Inc.: Examining Risks to Investors and the U.S. Posed by Foreign Issuers in U.S. Markets: Hearing Before the Subcomm. Investor Protection, Entrepreneurship, & Cap. Markets of the H. Comm. Fin. Serv., 117th Cong. (Oct. 26, 2021), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408558>.

⁵ For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

. . . Do you think that dual[-]class share structures are good, basically, for us as opposed to China and that we should support what we do because somehow it advantages our economy in some way or it advantages the way that we treat investors? Do you think it's good?⁶

As the leading voice for good corporate governance and shareholder rights, CII believes that dual-class share structures with unequal voting rights are disadvantageous to long-term investors and the U.S. economy. That is true whether those companies are based in China, the U.S., or other countries.

“One share, one vote” is a bedrock principle of good corporate governance.⁷ When a company taps the U.S. capital markets to raise money from public investors, those investors should have a right to vote in proportion to the size of their holdings. A single class of common stock with equal voting rights also better ensures that the board of directors is accountable to all of the shareholders.

Academic research⁸ and developing market practice⁹ confirm that any benefits that may be derived from dual-class share structures decline over time and ultimately the lack of accountability to shareowners’ harms investors and the capital markets generally.¹⁰

⁶ Transcript of Taking Stock of China, Inc.: Examining Risks to Investors and the U.S. Posed by Foreign Issuers in U.S. Markets: Hearing Before the Subcomm. Investor Protection, Entrepreneurship, & Cap. Markets of the H. Comm. Fin. Serv., 117th Cong. (Oct. 26, 2021) *available at* www.bgov.com (subscription required & on file with CII).

⁷ *See* Council of Institutional Investors, Corporate Governance Policies § 3.3 Voting Rights (updated Sept. 22, 2021), https://www.cii.org/files/09_22_21_corp_gov_policies.pdf (“Each share of common stock should have one vote [and] [c]orporations should not have classes of common stock with disparate voting rights”); *see also* Mark Wiseman, Opinion, Rethinking Rogers’s Dual-Class Share Structure, *Globe & Mail* (Oct. 25, 2021) (on file with CII) (“In public markets, the principles underlying their function should represent the values of fairness, legitimacy, and accountability – the hallmarks of all other aspects of public life”).

⁸ *See, e.g.*, Lindsay Baran, Arno Forst & M. Tony Via, Dual Class Share Structure and Innovation (Dec. 8, 2019), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3183517 (“Our results, which are robust to controlling for self-selection bias by using a sample of dual and single class firms matched on their innovativeness pre-IPO, . . . support the recent call for sunset provisions on dual class shares.”).

⁹ *See* Council of Institutional Investors, Companies with Time-Based Sunsets on Dual-Class Stock (updated, June 22, 2021), https://www.cii.org/Files/issues_and_advocacy/DualClassStock/7-22-21%20Time-based%20Sunsets.pdf (In 2021, 10 initial public offerings in the United States with dual class stock structures adopted time based sunsets that convert their structures to a one share, one vote structure in seven years or less); *cf.* Victory Board Approves Plan to Eliminate Dual-Class Share Structure, *BusinessWire* (Sept. 27, 2021), <https://www.businesswire.com/news/home/20210927005170/en/Victory-Board-Approves-Plan-to-Eliminate-Dual-Class-Share-Structure> (“David Brown, Chairman and CEO of Victory Capital, said, ‘We believe all shareholders will benefit from the elimination of the dual-class share structure by aligning voting rights with the economic interests of all shareholders [and] [s]implifying the Company’s capital structure such that all shareholders of the Company own a single class of common stock will also reduce the cost and complexity associated with the Company’s current capital structure.’”).

¹⁰ *See* Letter from Amy Borrus, Executive Director, Council of Institutional Investors to Capital Markets Policy Financial Conduct Authority (Sept. 14, 2021), <https://www.cii.org/files/September%20UK%20FCA%20Dual%20Class%20Consultation%20final.pdf> (providing an overview of the basis for CII’s opposition to dual class share structures and support for time-based sunsets in response to United Kingdom Financial Conduct Authority’s “Consultation Paper 21/21: Primary Markets Effectiveness Review”); Commissioner Robert J. Jackson Jr., Perpetual Dual-Class Stock: The Case Against Corporate Royalty, Speech, S.F., Cal. (Feb. 15, 2018), <https://www.sec.gov/news/speech/perpetual-dual-class-stock->

Perhaps the most visible current example of the potential harm of dual-class share structures is Facebook (now Meta). As was reported in the press just last week:

Facebook's tiered stock structure makes ousting Zuckerberg practically impossible. Although he owns less than half the company's stock, the class of shares Zuckerberg holds vote with much more power than common stock.

"He's a king, he's not a CEO," former Facebook employee Yael Eisenstat told Time earlier this month.

His powerful position at the helm of Facebook, Instagram and WhatsApp gives Zuckerberg "unilateral control over 3 billion people," Frances Haugen, the Facebook whistleblower, told UK lawmakers on Monday.¹¹

CII believes the Stock Exchange Improvement Act provides a thoughtful solution to preventing the next Facebook. Its provisions are consistent with U.S. corporate governance principles¹² and reflect sound, legislative policy recommendations of the U.S. Securities and Exchange Commission's (SEC) Office of the Investor Advocate.¹³ Those recommendations include provisions establishing minimum listing standards for the stock exchanges, including a provision that empowers shareholders of those companies that chose to list with multiple classes of stock with unequal voting rights.¹⁴

[case-against-corporate-royalty](#) (describing multi-class stock structures without sunsets as undermining "accountability: management can outvote ordinary investors on virtually anything"); *see generally* CFA Institute, DUAL-CLASS SHARES: THE GOOD, THE BAD, AND THE UGLY, A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific 93 (2018), <https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx> ("We have been urging exchanges that have DCS structures in place to consider mandating time-based sunset provisions, which means super voting rights will automatically convert to regular voting rights on a 'one-share, one-vote' basis after a period agreed upon between management and investors [and] [i]n our view, the single most important safeguard is a mandatory time-based sunset of not more than five years.").

¹¹ Allison Morrow, Zuckerberg's Power Makes Him Untouchable, *The Facebook Papers*, CNN Business (Oct. 27, 2021), <https://www.cnn.com/2021/10/27/tech/zuckerberg-facebook-papers-regulation/index.html>; *see* Mark Wiseman, Opinion, Rethinking Rogers's Dual-Class Share Structure, *Globe & Mail* ("Facebook, another U.S. tech giant with dual-class shares, has been a train wreck of corporate governance, largely because its structure allows the founder to maintain near-dictatorial control over the company and its investors.").

¹² *See* Council of Institutional Investors, Corporate Governance Policies § 3.3 Voting Rights; § 2.8b Board Diversity ("The Council supports a diverse board [and] [t]he Council believes a diverse board has benefits that can enhance corporate financial performance, particularly in today's global market place [and] [n]ominating committee charters, or equivalent, ought to reflect that boards should be diverse, including such considerations as background, experience, age, race, gender, ethnicity, and culture."); Council of Institutional Investors, CII Policies, Investor Expectations for Newly Listed Companies, https://www.cii.org/ipo_policy ("Upon going public, a company should have a 'one share, one vote' structure . . . [and] CII expects newly public companies without such provisions to commit to their adoption over a reasonably limited period through sunset mechanisms.").

¹³ *See* U.S. Securities and Exchange Commission, Office of the Investor Advocate, Report of Activities, Fiscal Year 2020 at 2, 10-11 (filed Dec. 29, 2020), <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2020.pdf>.

¹⁴ *See* U.S. Securities and Exchange Commission, Office of the Investor Advocate, Report of Activities, Fiscal Year 2020 at 10 ("If a company chooses to issue multiple classes of stock with differing voting rights, then the dual-class stock must contain a 'sunset' provision."); Rick Fleming, Investor Advocate, Dual-Class Shares: A Recipe for Disaster, Speech at ICGN Miami Conference, Miami, Fl. (Oct. 15, 2019),

As explained by Stock Exchange Improvement Act supporter California State Teachers' Retirement System:

We recommend [as proposed in the Stock Exchange Improvement Act] a simple, effective sunset mechanism on common stock structures with unequal voting rights, so that markets do not suffer long-term damage from perpetual or long-lasting multi-class stock structures. We believe that time-based “sunsets” are the way forward, requiring multi-class structures with unequal voting rights to collapse to one-share, one-vote within a reasonable and specified period after the initial public offering (IPO). A sunset of no more than seven years offers an appropriate period to harness whatever benefits of innovation and control a multi-class structure may provide while mitigating the agency costs it incurs over time. In recognition both of evolving market practice and academic research suggesting that multi-class structures become problematic five to nine years after the IPO, we request . . . a sunset of seven years or less.¹⁵

Among the many other supporters of the Stock Exchange Improvement Act are: Americans for Financial Reform;¹⁶ California Public Employees' Retirement System;¹⁷ Consumer Federation of America;¹⁸ Federated Hermes;¹⁹ Healthy Markets Association;²⁰ Los Angeles County

<https://www.sec.gov/news/speech/fleming-dualclass-shares-recipe-disaster> (“the sun-setting of super-voting rights, which would protect a visionary founder from activist investors for a reasonable length of time while preventing the harms that may occur over the long term due to poor corporate governance”).

¹⁵ Letter from Aeisha Mastagni, Portfolio Manager, Sustainable Investment and Stewardship Strategies, California State Teachers' Retirement System to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. 2 (Oct. 5, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/House%20FSC%20CII%20Draft%20Bill%20Comment%20Letter%20on%20Dual-Class%20Shares%20and%20Diversity%20Final.pdf.

¹⁶ See Letter from Americans For Financial Reform to Chairwoman Waters, Ranking Member McHenry, and Members of the Committee (Oct. 5, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/10_05_21-AFR-Support-Letter-to-HFSC-forHearing.pdf.

¹⁷ See Letter from Marcie Frost, Chief Executive Officer, California Public Employees' Retirement System to The Honorable Maxine Waters, Chair, House Committee on Financial Services, U.S. House of Representatives 1-2 (Oct. 1, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/Letter%20to%20HFSC%20Final.pdf.

¹⁸ See Letter from Dylan Bruce, Financial Services Counsel, Consumer Federation of America to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services et al. (Oct. 5, 2021), <https://consumerfed.org/wp-content/uploads/2021/10/CFA-Supports-House-Bills-to-Strengthen-Investor-Protections-Letter-10.5.21.pdf>.

¹⁹ Letter from Joanne Beatty, Director – Engagement, Hermes Equity Ownership Services Limited to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. (Oct. 11, 2021), <https://www.cii.org/Files/Hermes-CII%20governance%20and%20diversity%20disclosure-October%202021-PUBLIC.pdf>.

²⁰ See Letter from Tyler Gellasch, Executive Director, Healthy Markets Association to The Honorable Maxine Waters, Chairwoman, House Committee on Financial Services et al. (Oct. 5, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/HMA%20Letter-to-HFSC-re-Markup-10-5-2021-1.pdf.

Employees Retirement Association;²¹ North American Securities Administrators Association;²² Office of the New York State Comptroller;²³ Ohio Public Employees Retirement System;²⁴ Public Citizen;²⁵ Railpen;²⁶ and Washington State Investment Board.²⁷

Accelerating Act

At the Subcommittee Hearing, Representative Andy Barr stated: “I supported your [Chairman Brad Sherman’s] bill the Holding Foreign Companies Accountable Act [(HFCA Act)] because Chinese companies are not playing by the same rules as other foreign companies. And I support your bill [the Accelerating Act] to accelerate the timeline to two years”²⁸

CII membership-approved policies reflect the view that accurate and reliable audited financial statements are critical to investors in making informed decisions, and vital to the overall well-being of our capital markets.²⁹ For far too long, more than 13 years, there has been a gap in the Public Company Accounting Oversight Board’s (PCAOB) ability to inspect and investigate

²¹ See Letter from Jonathan Grabel, Chief Investment Officer, The Los Angeles County Employees Retirement Association to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. (Oct. 4, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/LACERA%20letter%20to%20House%20Financial%20Services%20Committee%20regarding%20CII%20bill%209%204%202021.pdf.

²² See Letter from Melanie Senter Lubin, NASAA President, Maryland Securities Commissioner to The Honorable Maxine Waters, Chairwoman, House Committee on Financial Services et al. 4-5 (Oct. 4, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/NASAA-Letter-to-HFSC-Re-10_5_21-Hearing-FINAL.pdf.

²³ See Letter from Thomas P. DiNapoli, State of New York, Office of the State Comptroller to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. (Oct. 1, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/Letter%20from%20NYS%20Comptroller%20Thomas%20P.%20DiNapoli.pdf.

²⁴ See Letter from Karen E. Carragher, Executive Director, Ohio Public Employees Retirement System to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services et al. (Oct. 1, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/OPERS%20Letter%20-%20Financial%20Services%20Committee%20-%20Draft%20Bill%20-%2010012021.pdf.

²⁵ See Letter from Public Citizen to Chair Maxine Waters, Honorable Members of the Committee, U.S. House of Representatives Financial Services Committee (Oct. 5, 2021), <https://www.cii.org/Files/Public%20Citizen%20comment%20on%20HFS%20bills%20Oct%205%20%202021.pdf>.

²⁶ See Letter from Michael Marshall, Head of Sustainable Ownership, Railpen et al. to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. (Oct. 1, 2021), [https://www.cii.org/files/issues_and_advocacy/correspondence/2021/Railpen%20letter_SEC%20Bill%20011021%20\(002\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2021/Railpen%20letter_SEC%20Bill%20011021%20(002).pdf).

²⁷ Letter from Theresa J. Whitmarsh, Chief Executive Officer, Washington State Investment Board to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, U.S. House of Representatives et al. (Oct. 14, 2021), https://www.cii.org/Files/WSIB_%20United%20States%20House%20Committee%20on%20Financial%20Services%20re%20CII%20legislation%20proposal%20_WSIB%20101421.pdf.

²⁸ Transcript of Taking Stock of China, Inc.: Examining Risks to Investors and the U.S. Posed by Foreign Issuers in U.S. Markets: Hearing Before the Subcomm. Investor Protection, Entrepreneurship, & Cap. Markets of the H. Comm. Fin. Serv., 117th Cong.

²⁹ CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), http://www.cii.org/policies_other_issues#indep_acct_audit_standards.

completely auditing firms located in China.³⁰ We believe the PCAOB's inability to inspect those firms has been to the detriment of long-term investors.³¹

More specifically, CII has long believed that for the protection of investors, all firms performing issuer audits should be subject to PCAOB inspections and investigations, without impediments from foreign authorities such as exists in China.³² Investors should be able to rely on the financial statements of issuers traded in the U.S., regardless of where the issuers' audits take place.³³

CII supported the HFCA Act because it will finally close the gap by requiring the PCAOB and the SEC to take actions consistent with their responsibilities under the federal securities laws to

³⁰ See, e.g., Soyoung Ho, Trump Administration Seeks to Delist U.S.-Listed Chinese Companies for Blocking Audit Inspections, Thomson Reuters Tax & Acct. (Aug. 10, 2020), <https://tax.thomsonreuters.com/news/trump-administration-seeks-to-delist-u-s-listed-chinese-companies-for-blocking-audit-inspections/> (“the PCAOB has not been able to get Chinese authorities to agree to a joint inspection program despite over 13 years of off-and-on negotiations.”).

³¹ See, e.g., Final Rule Concerning the Timing of Certain Inspections of Non-U.S. Firms, and Other Issues Relating to Inspection of Non-U.S. Firms, PCAOB Rulemaking Docket Matter No. 027, PCAOB Rel. No. 2009-003 at 8-9 (June 25, 2009), https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket_027/2009-06-25_release_no_2009-003.pdf?sfvrsn=61e7cb9b_0 (“The Board believes that it is not in the interests of investors or the public to exempt non-U.S. firms from the Act's inspection requirement given that the Board has previously determined not to exempt non-U.S. firms from the Act's registration requirements and given that an inspection is the Board's primary tool of oversight.”).

³² See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, PCAOB 6 (Sept. 6, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/September%206,%202018%20PCAOB%20Strategic%20Plan.pdf (“We are particularly concerned about PCAOB-registered firms located in China for at least four reasons: (1) since 2010 the PCAOB has actively sought without success inspections of China-based audit firms and the mainland affiliates of the Big Four accountancies - Deloitte, KPMG, PricewaterhouseCoopers and EY; (2) many of the China-based audit firms do significant work on audits of major U.S. companies doing business in China; (3) the recent surge in the number of Chinese companies listed on U.S. stock exchanges; and (4) most of the Chinese companies listed on U.S. stock exchanges in recent years have a variable interest entity structure that is highly complex and might include risks that some investors and auditors may not fully understand or appreciate.”); see also Council of Institutional Investors, Buyer Beware: Chinese Companies and the VIE Structure (Dec. 2017) https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf (describing the frequency and risks of Chinese companies with variable interest entity structures).

³³ See, e.g., Rebekah Goshorn Jurata, Board Member, PCAOB, Statement on the PCAOB's Proposing Release for Rule 6100, Board Determinations Under the Holding Foreign Companies Accountable Act (May 13, 2021), <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-the-pcaob-s-proposing-release-for-rule-6100-board-determinations-under-the-holding-foreign-companies-accountable-act> (“Investors should be able to rely on the financial statements of issuers traded in the United States, regardless of where the issuers' audits take place.”).

